Planning Ahead – Protecting the Home, Part II

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This is the second of a two-part article on protecting one's home from the risk of later having to be sold to pay for long-term nursing care. Last month's article discussed one way of doing this: transferring a remainder interest in one's home into an irrevocable trust while retaining a "life estate." That article focused on answering two questions regarding this planning technique: "*Why do this at all*?" and "*Why do it this way*?"

This month's article focuses on answering two other questions: If you know you want to protect your home from the risk of having to be sold after your death to pay an "estate recovery claim" by the Department of Public Welfare, and if you like the idea of still having full use and control of your home during your lifetime, you may still have two other questions: "*Why use an irrevocable trust?*" and "*Why do this now?*"

Why use an irrevocable trust? [1] Seniors who want to protect their home but are understandably uncomfortable simply putting it entirely into their children's names can transfer a remainder interest in their house directly to their children without using a trust. So wouldn't it be simpler not to bother with a trust at all?

The advantages of using an irrevocable trust for this purpose arise from a common situation with seniors as they age: the need to sell the house down the road. Perhaps the maintenance costs become too high for their income; or with declining health the upkeep – house cleaning and yard care and shoveling snow – becomes too demanding; or they need a single-story house to avoid stairs; or they need a level of care not available at home and so go to live with a child or move to an assisted living facility or nursing home.

But if the house is sold during the senior's lifetime, two issues arise:

1. Who signs the deed? By using the asset-protection strategy described in this article, you divide the ownership in your house into two interests, a "life-estate" interest and a "remainder interest." If the house is later sold, the parent or parents will sign the deed to transfer their life-estate interest, but who needs to sign to transfer the remainder interest?

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[1] To protect the house from the risk of having being sold to pay for long-term care, if a trust is used it needs to be "irrevocable." This is because the Pennsylvania Medicaid agency treats a house in a "revocable" trust as no longer "exempt" but rather a countable resource – which means it would either have to taken back out of the trust or sold before the owner could qualify for Medicaid.

If that interest is owned by the children directly, then to transfer good title each child, along with his or her spouse, would need to sign the deed. This might seem simple enough, but problems can arise in certain cases: for example, a child is going through a divorce at the time and it would be difficult to get the spouse's signature; or a child has died, requiring an estate to be opened and a Personal Representative appointed to sign the deed; or, as the result of accident or illness, the child is no longer mentally competent and has no Power of Attorney, thereby requiring a court proceeding to appoint a Guardian to sign. All of these potential problems can be avoided by the use of an irrevocable trust, since only the trustee (or successor trustee) needs to sign the deed to transfer the remainder interest.

2. <u>Capital gains tax</u>. As explained in last month's article, many houses owned by seniors are worth much more than their original purchase price. That increase in value is called "capital gain." Because the federal income tax laws exempt from tax the first $250,000 of capital gain from the sale of a house if the seller has lived there for two of the past five years, few if any seniors in northwest Pennsylvania will owe capital gains tax on the sale of their residence – much less a "life estate interest" in their residence.

However, as to the remainder interest, if it had been transferred to the children directly, then unless any of the children had been living in the house for at least two years, they will owe capital gains tax on their share of the sales proceeds (generally at a 15% tax rate). However, this tax issue can be avoided if the remainder interest is in the irrevocable trust; with the proper trust language the parents' $250,000 capital gains exclusion will apply to the remainder interest as well.

Why make this transfer now? For seniors who want to protect their homes in this way, there are several advantages of doing it now rather than waiting:

1. <u>Start a Five-Year Clock Running</u>. Under current law, any gifts made within sixty months (five years) prior to applying for Medicaid have to be disclosed on the Medicaid application. Such gifts will create a period of ineligibility for Medicaid. (For example, currently the gift of a house worth $100,000 would result in about one year of ineligibility.) But this period of ineligibility does not start to run until the senior is in the nursing home and "otherwise eligible" for Medicaid, meaning that he or she has no more than a few thousand dollars left to pay for any care (leaving open the question of who is going to be paying the nursing home during that ineligibility period). So, without proper guidance, it is quite risky to make large transfers of assets if nursing home care might be needed within the next five years.

But a look-back period of sixty months also means that <u>any gifts made more than sixty months prior to a Medicaid application do not have to be disclosed</u>. Thus, making a gift starts a five-year clock running, so that if at least sixty-one months goes by before a Medicaid application is filed, that gift will have no effect on one's eligibility for Medicaid.

2. Decreasing gift: By making this transfer sooner rather than later seniors would be creating a shorter period of ineligibility than if they *waited*, because as one gets older the value of his or her life estate decreases, which means the size of the remainder interest – and, thus, the gift – increases. (For example, at age 76 a life estate represents about 50% of the house value, which means the remainder interest is also 50%; at age 82, the life estate has dropped to 40%, meaning the remainder interest has grown to 60%.) Thus waiting until later to make this transfer creates a longer period of time that the senior would have to pay privately for nursing home care if needed within five years after making the transfer.

3. Getting the benefit of current law: Finally, making this transfer now allows seniors to take advantage of the five-year look-back *currently available in the Medicaid law*. It is impossible to predict how the Medicaid law will change in the future, or when such changes will occur. But it is almost certain that changes will occur in the future, and that the changes – such as increasing the look-back period – will be designed to make it more difficult for seniors to protect their assets. (This happened with the change in 2006 that, among other things, increased the look-back period from 36 to 60 months; however, *the change only applied to transfers made after the new law went into effect* on February 8, 2006. So those who had made transfers before that date got the advantage of the shorter period.)

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The content herein is for general informational purposes only and does not constitute legal advice. For specific questions you should consult a qualified elder law attorney.

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Note*: After the changes in the Medicaid law a few years ago, it is more true than ever that "time works against you" when planning for long-term care. It is important that families who have a spouse, parent or other loved one needing long-term nursing care contact a knowledgeable and experienced elder law attorney for advice as soon as possible. While ideally this should be done prior to admission to a nursing home, families need to realize* that even after the 2006 changes to the Medicaid law, there remain opportunities for seniors to protect a significant portion of their life savings, even when facing an immediate crisis, with no advance planning. *But since every day of delay in a crisis can result in $250 of irretrievable loss, don't delay in seeking advice.*

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